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November 11, 2000

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: *Ex Parte* in CC Docket No. 96-98/Implementation of the Local Competition Provisions of the Telecommunications Act of 1996

Dear Ms. Salas:

Several parties have filed *ex parte* letters recently that address the exception to the requirement that incumbent local exchange carriers (ILECs) provide unbundled switching to requesting carriers.[1] In this *ex parte* letter, WorldCom responds to those letters by urging the Commission to focus its "impairment" analysis on what is actually happening in telecommunications markets today. Such an analysis would support a switching exception limited to the largest 50 MSAs, where the ILEC is providing competitive local exchange carriers (CLECs) unconstrained access to loop-transport combinations (EELs), and where the customer is receiving service at the DS-1 level or greater.

It has become increasingly clear that the mere existence of a CLEC switch does not demonstrate that the company that deployed that switch can profitably provide service using that switch. Nor does it provide other CLECs with an alternative to ILEC switching capacity needed to viably offer service. While ILECs have pointed to widespread CLEC switching investments as "evidence" that CLECs would not be impaired in their ability to provide such services without access to ILEC switching, that "evidence" falls far short of a market test for impairment. Indeed, current market activity strongly suggests that for a variety of reasons -- the inability to use the switching capacity efficiently, lack of demand, etc. -- a number of firms have deployed switching capacity but are not able to viably offer telecommunications services using that capacity. Many

[1] See, for example, the October 25, 2000 joint letter to Magalie Roman Salas filed by Allegiance Telecom, Cablevision Lightpath, Inc., Cbeyond Communications, Time Warner Telecom, and XO Communications (Joint Letter), the October 20, 2000 letter to Dorothy Attwood filed by Verizon (Verizon Letter), the October 11, 2000 letter to Dorothy Attwood from AT&T (AT&T Letter), and the October 13, 2000 letter to Magalie Roman Salas filed by the PACE Coalition (PACE Letter).

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of these CLECs now face tenuous financial situations, at best.[2] Thus, the mere number of switches deployed is insufficient evidence upon which to base the impairment analysis.

In reviewing the four parameters in the current switching exception (the availability of EELs; the size of the customer served, in terms of lines; the size of the market, in terms of MSA rank; and the portion of the MSA to which the exception would apply), the Commission should be seeking two sets of information: (1) market evidence that demonstrates that CLECs are or are not able to profitably offer telecommunications services when using their own switching; and (2) since no CLEC can build out its network in all geographic markets simultaneously, market evidence that demonstrates that CLECs are or are not able to viably use the switching capacity of carriers other than the ILEC to offer telecommunications services.

The Availability of EELs

The Commission correctly has found that CLECs cannot efficiently use their own switches, and therefore are impaired in their ability to offer telecommunications services if denied access to ILEC switches, if they do not have access to loop-transport combinations to efficiently concentrate and bring their customers' traffic to their switches. The market imperative is clear: although, given their smaller market shares, CLECs may not be able to achieve the same scale economies as the ILECs, they must at least have the opportunity to operate as close to that level of efficiency as possible. CLECs cannot and should not replicate the ILECs' ubiquitous loop networks. Moreover, given the relatively small amount of traffic any individual CLEC will have at any particular central office, in many situations the underlying costs do not justify a CLEC replicating the ILECs' transport networks either. Furthermore, given the latest switching and transport technology, it is far more efficient for CLECs to utilize one or a small number of switches to cover the geographic territory served by multiple ILEC switches. Thus, to be able to compete with the ILECs, CLECs must be able to concentrate its traffic and transport it efficiently to a single or limited number of switches. The only way to accomplish this is through unrestricted use of EELs to provide local service. There is no evidence on the record that refutes this.

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[2]According to a CBS Marketwatch Telecom Report dated November 2, 2000, "While there are about 45 publicly traded U.S. CLECs, many industry insiders say they expect up to half to disappear next year, either through takeover or outright failure." More direly, the November 1, 2000, Telecommunications Reports Daily states:

> The pace of consolidation in the competitive local exchange carrier (CLEC) sector will accelerate next year, but most of the acquisitions will be of the 'fire sale' variety, CLEC executives predicted today [at the Bear, Stearns & Company Global Communications Conference]. A lot of mergers and acquisitions will be 'Sanford and Son M&A,' in which the acquired company is 'sold for scrap' because it is about to go bankrupt, said Royce J. Holland, chairman and chief executive officer of Allegiance Telecom, Inc.

Having no empirical evidence to refute this market analysis, the ILECs now seek to circumvent this impairment analysis by making irrelevant legal arguments. They have made two such legal claims.[3] First, they claim that requiring ILECs to provide these "new combinations" as a condition for the switching exception is inconsistent with the Telecommunications Act as interpreted by the Eighth Circuit. Second, they claim that the commingling prohibition in the Supplemental Order Clarification in this docket supercedes any EELs requirement in the switching exception. These are specious arguments. The Commission is not requiring ILECs to provide EELs. Rather it simply is performing the statutorily-mandated impairment test and determining that CLECs are not impaired without access to unbundled ILEC switching if the ILEC provides EELs, but are impaired if the ILEC does not provide EELs. Thus, any switching exception correctly must be limited to situations where the ILEC is providing unrestricted access to EELs. ILECs are not required to provide EELs; they simply are granted an exception to the UNE switching requirement if they offer EELs.

Size of Customer Served

Both AT&T and the PACE Coalition have filed analyses in this docket demonstrating that, in addition to the operational problems associated with hot cuts, the economics that CLECs face when using their own switches in conjunction with unbundled ILEC loops to provide local service to customers do not allow them to compete with ILECs at lower than the DS-1 level.[4] WorldCom's internal financial analyses confirm these numbers and have discouraged us from serving small business customers without access to the ILEC platform unless the customers are physically located on one of our fiber rings. In the current capital market environment, the bad underlying economics cannot be papered over.

The only contrary evidence in the record is provided in the Joint Letter, which states that in 26 of the top 50 MSAs, "Allegiance specifically targets the small-to-medium business market, focusing on customers with 4 to 24 lines. Similarly, Cbeyond, which has not yet begun to provide local service, plans to target small business customers with 5 to 25 lines." (There was no mention in the Joint Letter that the other three signatories offer service to small business customers.) WorldCom has great respect for Allegiance and its accomplishments to date, but believes that the Commission should not reach the determination that it is viable for CLECs to serve small business customers using their own switches based on the business plans of one company that still has not shown a profit and a second company that has not even begun to offer such service.

Size of the market

The ILECs seek to expand the switching exception to the top 125 MSAs, based on the

[3] See Verizon Letter.

[4] See AT&T Letter and PACE Coalition Letter.

claim that CLEC switch deployment and NXX code assignments in markets below the top 50 demonstrate that CLECs who do not have access to unbundled ILEC switching would not be impaired in their ability to offer services in those markets.[5] As WorldCom has explained in detail in an earlier *ex parte* letter,[6] LERG data on NXX code assignments do no more than identify where CLECs have obtained numbers; they do not show that CLECs are actually using the numbers and their own switches to offer services, nor do they show the type of services offered by the CLECs with their switches. They are misleading as evidence of where CLEC service and sales are taking place.

Nor, as is becoming increasingly clear in the current market environment of CLEC failures, are data on CLEC switch deployment indicative that CLECs can viably use their switches to offer telecommunications services. It is notable that the Joint Letter submitted by five facilities-based CLECs identified their presence in the largest 50 MSAs, not in smaller MSAs. This is not surprising. As WorldCom demonstrated in an empirical econometric analysis it submitted in August 1999,[7] the underlying economics does not support deployment of switches by multiple CLECs beyond the largest MSAs.[8] In a limited number of situations, one or a small number of CLECs may be able to use a "first in" advantage to viably serve customers in second and third tier markets,[9] but the limited number of business access line in these markets will limit

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[5] See, for example, July 12, 2000 SBC letter to Magalie Roman Salas and June 12, 2000 and July 13, 2000 Qwest letters to Magalie Roman Salas.

[6] Letter to Magalie Roman Salas accidentally misdated as 20 April, 2000, but actually submitted on 20 July, 2000.

[7] Letter to Larry Strickling dated August 9, 1999.

[8] The economics are quite simple. Currently, CLECs can viably use their own switches for the provision of service to business -- but not mass markets -- customers. The decision to deploy a switch therefore will depend primarily on potential business demand in a market -- as measured by the total number of business lines. A CLEC can optimistically seek a 10 percent share of the business market in any MSA; any business plan based on a larger market share would be far too risky. At the same time, to exploit sufficient scale economies to be competitive with the ILECs, a CLEC must serve in the neighborhood of 40,000 lines with its switch. Only about 30 MSAs have 400,000 business lines. The 50th largest MSA has only about 250,000 lines. Thus, even the top 50 MSA cutoff is on the high side.

[9] For example, if WorldCom already were providing the long distance services for a very large business customer in a market below the top 50, it might make sense to deploy a switch and fiber ring in that market because by capturing that single customer's local service plus some smaller customers it might be able to utilize its switch and fiber network in the market at a reasonably efficient level, though the same calculation would not hold without the existence of the single large customer.

the number of CLECs for whom this would be a viable option. WorldCom explained this more fully in an earlier *ex parte* letter.[10]

In theory, CLECs would not be impaired in their ability to offer services in these markets below the top 50 if those few CLECs that have deployed switches made their switching and network capacity available on a wholesale basis -- in a "UNE-platform" arrangement. But that has not happened; there isn't even a nascent wholesale market for CLEC switching capacity. It is noteworthy that none of the five facilities-based carriers that are signatories to the Joint Letter have marketed their switching or platform capabilities to WorldCom.[11] Until such a wholesale network develops, the mere existence of CLEC switching capacity in markets below the top 50 cannot be relied upon as an alternative source to unbundled ILEC switching.

<u>Portion of the MSA to which the Exception Should Apply</u>

This parameter cannot be addressed in a vacuum, as the viable reach of a CLEC switch will depend on how efficiently the CLEC can concentrate its customer traffic and transport that traffic to its switch. Every CLEC seeking to serve customers beyond those physically on its fiber rings has identified access to EELs as necessary to efficiently perform the concentration and transport functions.[12] If, and only if, EELs are available at TELRIC rates, thus allowing CLECs to efficiently concentrate and transport traffic to a single switch in an MSA, the exception could cover the entire top 50 MSAs. If there is a restriction of any sort on the availability of EELs, however, then the switching exception must be limited to the business areas where CLECs have deployed their fiber optic networks.

WorldCom supports expansion of the switching exception to the full boundaries of the largest 50 MSAs, where the ILEC is providing EELs and the customer has service at at least the DS-1 level, despite the fact (described in its *ex parte* letter of June 21, 2000) that most of these

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[10] June 21, 2000 letter to Magalie Roman Salas, at p. 5.

[11] Footnote 9 of the Joint Letter notes that "the Commission has recognized that it is proper to consider the effect of its rulings on competitive carriers' established lines of business.... To change the rules governing unbundled switching at this point would allow users of the UNE-platform to undercut facilities-based carriers such as Allegiance, Cbeyond, Lightpath, TWTC, and XO. This arbitrage opportunity would make it more difficult for these carriers to recover their investments and would discourage facilities-based competition, thereby undermining a fundamental goal of the 1996 Act." Given that these facilities-based CLECs are not marketing their facilities to other providers on a wholesale basis, however, this argument rings false. It is no more than an attempt by these companies to protect their "first to market" advantages by simultaneously maintaining an above cost price ceiling on switching while requiring later entrants to make a full-facilities-or-nothing investment decision on entry.

[12] See, for example, the Joint Letter submitted by five facilities-based CLECs.

top 50 MSAs are so geographically large that WorldCom and other CLECs may not be able to use their own switches to compete effectively with the ILEC in the outer reaches of those MSAs. Unfortunately, no party has been able to identify a better boundary marker than the MSA.

Sincerely,

Chuck Goldfarb

Chuck Goldfarb
Director, Law and Public Policy

cc. Dorothy Attwood
Glenn Reynolds
Michelle Carey
Katherine Farroba
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